FISCAL NOTE

Bill #: SB0371 **Title:** Revise taxation of capital gains

Primary Sponsor: Stonington, E **Status:** As Introduced

Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary	**FY 2004 Difference**	**FY 2005 Difference**
Expenditures:		
General Fund	$18,213	
Revenue:		
General Fund	$(160,000)	$(40,000)
Net Impact on General Fund Balance:	$(178,213)	$(40,000)

- ☐ Significant Local Gov. Impact
- ☐ Included in the Executive Budget
- ☐ Dedicated Revenue Form Attached
- ☐ Technical Concerns
- ☐ Significant Long-Term Impacts
- ☒ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. This bill changes the tax treatment of net positive capital gains income. Under this bill, net capital gains would not be included in the regular computation of individual income tax liability; capital losses would continue to be included in the regular computation of liability. Capital gains would be subject to taxation based on a separate tax rate table that mirrors the current law tax rate table except that every tax rate in the regular tax rate table would be reduced by one percentage point. That is, the tax rate table for capital gains income would have rates that ranged from 1% to 10% based on the same bracket boundaries that are in the current law rate table; whereas the regular rate table has rates that range from 2% to 11%.
2. This proposal appears intended to provide for preferential treatment of capital gains income resulting in a reduction in general fund collections. However, a detailed simulation analysis of this proposal indicates that this bill, as introduced, is very close to being revenue neutral. The following table shows the reduction in tax liability that arises as a consequence of removing capital gains income from the computation of regular income tax, the offsetting increase in revenue that arises as a consequence of taxing capital gains using the modified tax rate table with reduced tax rates, the net tax year impact, and the associated fiscal year impacts:

SB371 Tax Year and Fiscal Year Impacts				
Tax Year	Decrease in Tax from Removing Capital Gains Income	Increase in Tax on Capital Gains Income	Net Change in Tax Year Liability	Fiscal Year Impact
2003	(30,833,577)	30,688,919	(144,658)	0
2004	(47,919,230)	47,883,383	(35,847)	(160,000)
2005	(54,250,261)	54,336,050	85,789	(40,000)
2006	(56,129,356)	56,300,217	170,861	97,000
2007	-	-	-	197,000

3. As the table shows, there is little impact on tax year liability and fiscal year revenues as a result of this bill. This is because for instances in which taxpayers would receive a net benefit from removing capital gains from the regular computation of tax and taxing them at reduced rates in the new rate table applied to capital gains, there are offsetting increases in tax from other taxpayers who also would be required to do this. For example, take the case of a taxpayer who has $50,000 of capital gains income and a $25,000 net operating loss. Under current law, this taxpayer would pay taxes based on $25,000 of net income. Under this bill, the taxpayer's regular tax would be zero, as only the $25,000 of net operating loss would be subject to tax under the regular tax computation. But the entire $50,000 of capital gains income would now be subject to tax under the rate table with the reduced rates, subjecting the entire amount of capital gains to tax. Even with reduced rates, this taxpayer's tax bill will increase nearly two-fold.
4. This is further illustrated by the fact that in tax year 2003 there is forecast to be a total of about $510 million in net capital gains reported on income tax returns. However, removing these gains from the regular tax computation would reduce taxable income by just $365 million because many taxpayers with capital gains income have either zero taxable income to begin with, or have less taxable income than capital gains income. On the other hand, the entire $510 million of net capital gains income would be subject to taxation based on rates in the new table provided specifically for capital gains. The net effect of these combined computations is that the bill is very close to being revenue neutral each year.
5. The Department of Revenue would have to make modifications to the individual income tax data processing systems to accommodate the changes to the regular tax form, and provide for an additional tax rate table specifically applied to capital gains income. This increases administrative expenses by $18,213 in fiscal year 2004.

FISCAL IMPACT:	FY 2004	FY 2005
Expenditures:	Difference	Difference
Personal Services	$13,798	
Contracted Services	4,415	
TOTAL	$18,213	
Funding of Expenditures:		
General Fund (01)	$18,213	
Revenues:		
General Fund (01)	$(160,000)	$(40,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$(178,213)	$(40,000)